

# RatingsDirect®

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## Summary:

# Northampton, Massachusetts; General Obligation

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## Summary:

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Credit Profile		
US\$8.0 mil GO rfdg bnds due 12/01/2031		
Long Term Rating	AAA/Stable	New
Northampton GO		
Long Term Rating	AAA/Stable	Affirmed

## Rating Action

S&P Global Ratings assigned its 'AAA' rating to Northampton, Mass.' series 2022 general obligation (GO) refunding bonds, totaling about \$8 million. At the same time, S&P Global Ratings affirmed its 'AAA' rating on the city's GO debt outstanding. The outlook is stable.

Northampton's full-faith-and-credit GO pledge, subject to Proposition 2-1/2 limitations, secures the bonds. Despite commonwealth levy limit laws, we do not make a rating distinction between Northampton's limited-tax bonds and its general creditworthiness because our analysis of its financial and economic conditions already includes the statutory limitation imposed on its revenue-raising ability.

Officials plan to use the bond proceeds to refinance the city's outstanding series 2014 GO bonds for an interest rate savings.

## Credit overview

Northampton consistently maintains reserves higher than the median for comparably rated state peers. Its financial results are a direct result of an active financial management team and well-embedded policies and practices. We expect that the new mayoral administration and financial management staff will make minor updates to the policies, but ultimately the city will continue to adhere to its long-standing financial practices and, as a result, maintain at least balanced operations, leading to maintenance of very strong cash balances and available reserves. Although we view its debt and contingent liability profile as manageable, we believe pension and other postemployment benefit (OPEB) costs will remain a long-term credit pressure, given the size of the liabilities and low funded ratios. Nevertheless, the stable outlook reflects our view of the city's consistent performance and expectation that management will incorporate these costs into its multiyear forecasting and budgeting. We do not expect to change the rating during the two-year outlook period.

Northampton's GO bonds are eligible to be rated above the sovereign because we believe the city can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria "Ratings Above The Sovereign: Corporate And Government Ratings--Methodology And Assumptions" (published Nov. 19, 2013, on RatingsDirect), Northampton has a predominantly locally derived revenue source, with property taxes accounting for about 58% of general fund revenues. It also has independent taxing authority and independent treasury management from the federal

government.

The long-term rating reflects our opinion of the city's:

- Growing tax base and participation in a broad and diverse metropolitan statistical area (MSA) and expectation of continued improvement in local employment conditions;
- Very strong financial management environment that we expect will continue through recent personnel changes, and a strong institutional framework;
- Consistent financial results, supported by a generally stable revenue and expenditure profile, leading to high cash and reserve balances; and
- Low debt service carrying charges and debt relative to revenue, but with a large pension and OPEB obligation and the lack of a plan to sufficiently address it.

### **Environmental, social, and governance**

We analyzed the city's environmental and governance risks relative to its economy, management, financial measures, and debt and liability profile, and determined that all are in line with our view of the sector standard. The city also maintains various cyber-security protections and plans in place.

## **Stable Outlook**

### **Downside scenario**

We could lower the rating if budgetary performance weakens, leading to reduced reserves and constrained liquidity.

## **Credit Opinion**

### **Stable economic profile with a growing economic base and participation in a broad and diverse MSA**

Northampton is within the "Knowledge Corridor;" is home to Smith College; and is near Amherst College, Mount Holyoke, UMass Amherst, and Hampshire College. Further supporting its economic profile is its participation in the Springfield MSA. The city has a vibrant arts and culture community, which is helping it draw additional residential and commercial development. Nearly half Northampton's residents find employment in the education and health services industries, with the trade, transportation, and utilities and leisure and hospitality industries employing the next-largest shares of city residents.

Notably recent and ongoing developments include Smith College's redesign and expansion of its Nielsen Library, which consists of a \$100 million project to attract further interest in the college. The Village Hill Campus redevelopment project, at the site of a former state hospital, is under multistage conversion into a mixed residential and commercial site. Management reports residential infill, as well as continued investment in solar arrays and in the cannabis industry. Given the demonstrated growth in the tax base over the past several years and with significant projects underway, we expect continued growth in the tax base and underlying wealth and income metrics.

### **Well-embedded financial policies and practices**

Northampton recently elected a new mayor, resulting in turnover within the financial administration team. We understand the city is undertaking a review of its policies and practices to ensure they continue to comply with best practices. We do not expect any major change in its financial policies.

Northampton is conservative in its management and budgeting practices. Officials develop revenue and expenditure assumptions using up to 10 years of historical trends in combination with forward-looking, long-term financial planning. Management presents budget-to-actual reports quarterly to the city council and posts daily expenditures to the city website via its "Open Checkbook." The city maintains a five-year forecast that it updates annually and uses to project expenditure and revenues issues, along with ways to address them. Northampton also has a five-year, rolling capital improvement plan (CIP). Both long-term plans are available to the public on the city's website.

Northampton's financial policies include investment management, debt management, and reserve policies. The investment management policy requires annual reporting, and the debt management policy includes thresholds on debt issuance. The reserve policy calls for a stabilization fund balance of 10% of operating expenditures. Northampton complies with all its policies.

The city has cyber-security protections in place and maintains various backups of its networks and systems, as well as cyber-security insurance.

### **Consistently strong budgetary performance leading to maintenance of high reserve, cash balances**

The city is somewhat more reliant on nonproperty tax revenue than similarly rated state peers. Based on the draft audit, in fiscal 2021, local property taxes accounted for 58% of general fund revenue. In aggregate, local, nonproperty tax revenues accounted for about 19%, including licenses/permits (10%) and charges for services, hotel/meals/cannabis taxes, and other excise taxes, each totaling about 3%. Intergovernmental aid was 13%. To offset potential revenue volatility entering fiscal 2021, the city reduced its budget 0.5% from 2020. It reduced nonessential spending, OPEB trust contributions, and certain capital projects to match budgeted revenue loss. However, revenues in all categories exceeded budget, and expenditures were under budget, leading to the year-end surplus. Management worked to maximize the use of federal relief funding and limit taxpayer exposure to unbudgeted health and safety costs. We do not expect material change between the draft and final audits.

The fiscal 2022 budget restored personnel positions cuts in the prior year and continues investments in infrastructure that were delayed. In particular, the budget includes initial funding for the new Department of Community Care, a nonpolice emergency response unit. We understand revenues and expenditures are on budget, with clear recovery in local, nonproperty tax revenues, particular in hotel and restaurant receipts. We expect the city to show at least balanced operating performance at year-end. The 2023 budget process is underway, but outside of incremental staffing growth at the new Department of Community Care, the city does not expect a material budgetary changes with generally level staffing and growth based on contractual cost growth. It is set to receive about \$22 million in American Rescue Plan Act funds. It expects to expend approximately \$6 million on water and wastewater projects, with a dedicated \$10 million identified as lost revenue for capital projects, and is undergoing community outreach to identify the best uses for \$4 million.

Given the revenue recovery and management's demonstrated willingness to adjust the budget to maintain balance, we

expect continued strong budgetary performance and maintenance of very strong budgetary flexibility and liquidity profiles. Further supporting our view is the city's demonstrated willingness to raise taxes. On March 3, 2020, voters approved a \$2.5 million general operating override of the levy limit. We also understand a portion of the revenues from the override will go toward the city's fiscal stability reserves (within unassigned fund balance), with the remainder incorporated into the operating budget.

### **Stable debt profile with no major debt plans in the near term**

Northampton has approximately \$40.2 million in net direct debt, after accounting for self-supported enterprise debt. The city expects to issue about \$7 million in additional debt for various capital projects, as part of its CIP over the next two years. We do not expect a material change in its debt ratios.

### **Elevated retirement costs that may continue to rise**

- We view pension and OPEB liabilities as a source of credit pressure for Northampton, given that costs represent a notable portion of the budget, and we expect they will increase.
- Because the city's pension actuarially determined contribution is built from what we view as weak assumptions and methodologies, we believe it increases the risk of unexpected contribution escalations. However, we expect higher contributions will likely remain affordable in the short term, given the city's conservative budgeting assumptions and very strong reserve levels.
- Although OPEB liabilities are funded on a pay-as-you-go basis, which, given claims volatility as well as medical cost and demographic trends, is likely to lead to escalating costs, the city has legal flexibility to alter OPEB benefits, which we view as a potential means of mitigating escalating costs.

As of the fiscal year 2021 audit, the city had the following plans and liabilities:

- Northampton Contributory Retirement System (NCRS): 80% funded, \$38.6 million net pension liability, measured with a 7.125% discount rate.
- A defined-benefit health care plan that provides both explicit subsidies: 2% funded, \$156 million net OPEB liability.

NCRS is currently on track for full funding by 2037, three years ahead of the commonwealth-mandated deadline of 2040. However, we view the plan's payroll growth assumption of 4% as optimistic, and we believe it could lead to increases in retirement contributions if the target is not consistently achieved. We believe its discount rate is high relative to our 6.0% guideline and introduces contribution volatility risk. We note that the city overfunded contributions in each of the last five years, reflecting its budgetary flexibility and intent to fully address the pension liability.

Management maintains an OPEB trust fund with a current balance of \$3.3 million. The city had initially planned to contribute about \$350,000 to the fund in fiscal 2021. However, to cut costs for the year, it level funded this contribution at the fiscal 2020 level of \$300,000. The city plans to add at least \$350,000 in the trust in fiscal 2022 and increase that amount by \$50,000 minimum every year. We also understand it plans to make additional appropriations to the trust when possible.

The city is managing its retirement costs and we expect it will continue to do so given the strengths of its financial management environment and budget flexibility. However, we expect costs will continue to grow and could potentially

pressure the budget, particularly given the low funded ratio and large unfunded liability within the OPEB plan without a plan to fully fund the liability.

### Strong institutional framework

The institutional framework score for Massachusetts municipalities is strong.

Table 1

Northampton, MA -- Key Credit Metrics				
	Most recent	Historical information		
		2021	2020	2019
<b>Very strong economy</b>				
Projected per capita EBI % of U.S.	114			
Market value per capita (\$)	135,560			
Population		28,908	29,170	
County unemployment rate(%)		7.2		
Market value (\$000)	3,918,773	3,733,722	3,680,795	
Ten largest taxpayers % of taxable value	5.2			
<b>Strong budgetary performance</b>				
Operating fund result % of expenditures		4.1	2.5	4.2
Total governmental fund result % of expenditures		3.1	1.9	3.5
<b>Very strong budgetary flexibility</b>				
Available reserves % of operating expenditures		31.3	27.3	26.5
Total available reserves (\$000)		34,337	29,785	27,034
<b>Very strong liquidity</b>				
Total government cash % of governmental fund expenditures		59	48	46
Total government cash % of governmental fund debt service		1,580	927	852
<b>Very strong management</b>				
Financial Management Assessment	Strong			
<b>Very strong debt &amp; long-term liabilities</b>				
Debt service % of governmental fund expenditures		3.8	5.2	5.4
Net direct debt % of governmental fund revenue	29			
Overall net debt % of market value	1.0			
Direct debt 10-year amortization (%)	76			
Required pension contribution % of governmental fund expenditures	4.9			
OPEB actual contribution % of governmental fund expenditures	3.6			
<b>Strong institutional framework</b>				

EBI--Effective buying income. OPEB--Other postemployment benefits.

## Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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